

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
)	CC Docket No. 96-45
Federal-State Joint Board on)	
Universal Service)	

REPLY COMMENTS OF JOHN STAURULAKIS, INC.

John Staurulakis, Inc. (“JSI”) provides these reply comments to the Federal-State Joint Board on Universal Service (“Joint Board”) in response to comments provided by various parties in the above captioned proceeding.¹

I. Introduction

JSI continues to urge the Joint Board to recommend to the Federal Communications Commission (“FCC”) that it consider the interrelatedness of this proceeding with other proceedings dealing with rural carriers. In light of the preponderance of comments filed in this proceeding, JSI strongly encourages that the Joint Board recommend continued use of the statutory definition of “rural carrier” for federal universal service purposes and continued use of embedded cost mechanisms to determine the level of federal universal service support for rural carriers.

¹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, FCC 04J-2, rel. Aug 16, 2004.

The comments filed in this proceeding addressed the three issues raised by the Joint Board and more. In these reply comments, JSI urges the Joint Board to reject the arguments made by certain parties to adopt a forward-looking economic cost model to determine federal universal service support. As demonstrated herein, a forward-looking model does not work and will not lead to the “state of bliss” promised by its proponents.

The Joint Board has the task of examining the efficacy of various proposals related to cost modeling. It seems all parties commenting in this proceeding generally agree that federal universal service should be based on the cost of providing telecommunications services to customers in areas served by rural telephone companies. What is at issue is the determination of these costs. The division between the commenting parties falls along the lines of those proposing the use of a forward-looking economic cost model to estimate these costs and those proposing continued use of embedded cost mechanisms as the basis to estimate universal service costs. The primary debate in this proceeding may be characterized as a debate over cost modeling.

JSI explores several issues that reveal fundamental problems in the use of forward-looking economic cost modeling in this proceeding. Without evidence to solve these problems, the use of a forward-looking model is more a wish than a legitimate public policy option.

II. Fundamental Problems with Forward-Looking Cost in this Proceeding

Several parties comment on the benefits of using forward-looking economic cost. CTIA is perhaps the standard bearer for forward-looking modeling. CTIA argues the FCC has already determined that universal service for rural carriers should be based on forward-looking economic costs.² JSI believes there is a fundamental disconnect between CTIA's position and the *Referral Order* directing the Joint Board to recommend whether embedded or forward-looking costs should be used in the period following the RTF period.³ If the FCC has already determined to focus solely on forward-looking economic cost for rural carriers, then this entire comment cycle addressing the appropriate cost modeling methodology has been a sham and a waste of public and private resources. In the alternative, JSI believes the FCC's referral to the Joint Board is a *de facto* examination of whether its prior declarations are appropriate for rural carriers given what we know about forward-looking cost modeling. JSI recommends the Joint Board give this CTIA argument little weight in its recommendation.

Sprint argues for forward-looking modeling based on two principles echoed in part by other parties.⁴ The two principles are based on the need to provide a proper price signal to market entrants and to avoid alleged inefficiencies in the embedded cost mechanisms. JSI notes that the industry has heard this refrain from Sprint and others

² Comments of CTIA – The Wireless Association™ at 20.

³ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, FCC 04-125, rel. Jun. 28, 2004. (“*Referral Order*”) (“We expect that the Joint Board will consider all options for determining appropriate support levels for rural carriers.” *Id.* at 2. “We ask the Joint Board to consider whether a universal service mechanism for rural carriers based on forward-looking economic cost estimates or embedded costs would most efficiently and effectively achieve the Act’s goals.” *Id.* at 8).

⁴ Comments of Sprint Corporation at 2. *See also* Comments of CTIA at 7 and Comments of Dobson Cellular Systems, Inc. at 6.

many times before. Upon a closer inspection, Sprint's advocacy for a forward-looking model fails to achieve its goal.

Regarding a correct price signal, proponents for forward-looking modeling suggest that CLECs and CMRS providers are awaiting a correct price signal to determine whether they should enter a rural market. JSI hardly believes national and regional CMRS and CLEC providers need a price signal from the rural carrier in the form of a universal service level to determine whether they should enter a market. Furthermore, if a forward-looking economic costs ("FLEC") price signal can be justified, it must reflect their scale and scope economies, not the scale and scope economy reflected in a rural carrier's forward-looking cost for providing universal service. Sprint admits that economies of scale play an important role in determining a rural support level.⁵ However, Sprint fails to connect this important modeling principle with the price signal to be given a competing carrier.⁶ JSI recommends the Joint Board reject the claim that a universal service forward-looking cost in the form of a "price signal" would benefit marketplace entry.

⁵ Sprint at 2. (For FLEC to be estimated accurately, it is necessary for the cost calculation to include all the factors that cause variations in costs: factors that vary with the area being served, as well as factors that vary with the size of the company serving the area. Inputs to a cost calculation-such as purchase prices for outside plant materials-often vary significantly depending on the size of the company that is doing the purchasing: companies purchasing smaller volumes of materials also receive smaller discounts on purchase prices. The Commission itself has made explicit reference, with regard to the purchase of equipment, to the "superior buying power" of larger carriers. This variation in costs does not reflect inefficiencies on the part of the company; rather it reflects the simple realities of market-based prices characterized by volume discounts available to companies with sufficient scale.)

⁶ A point that is lost by most critics of an embedded cost mechanism is the fact that economies of scale and scope are already captured in the embedded cost mechanisms.

The second issue raised by proponents of a forward-looking cost policy, including Sprint, is the alleged inefficiencies in an actual cost mechanism. What these proponents fail to acknowledge is the high likelihood that forward-looking cost will produce inefficiencies and inequities in the calculation and distribution of federal universal service support. CTIA states a “properly designed” forward-looking methodology will do a better job than an embedded cost system.⁷ The comments of CTIA and other forward-looking proponents categorically fail to defend this claim. There is not a shred of evidence in the comments thus presented that demonstrates: (1) the criteria for determining a properly designed forward-looking cost methodology, and (2) how forward-looking cost would be modeled, with precision, for areas served by rural carriers. The FCC’s forward-looking model used for non-rural carriers is more of a claim against forward-looking modeling than it is a defense of the concept.⁸ JSI respectfully submits that the lack of candor from forward-looking model advocates regarding the difficulty of rural cost modeling shows a disturbing lack of comprehension concerning modeling techniques. All modeling mechanics have flaws and obstacles, and forward-looking modeling is no exception. The public policy choice before the Joint Board is largely a choice between second-best alternatives. The rhetoric from forward-looking proponents borders on religious dogma, which neglects to recognize forward-looking modeling problems in advocating a replacement of the current embedded cost mechanisms.

Until a forward-looking model is developed, examined, tested, and verified, JSI respectfully submits that the Joint Board should not entertain adopting it as a

⁷ CTIA at 19.

⁸ See JSI Comments in this proceeding, note 23.

methodology for the calculation and distribution of federal universal service for rural carriers. To do so would be similar to jumping into a boat headed to sea without knowing whether the boat is suitable for the challenges of ocean travel. JSI urges the Joint Board not to jump on board simply because of alluring claims of efficiency that have not been proven through actual testing and verification for rural carriers.

Another fatal flaw in the arguments made by forward-looking proponents is their claim that a forward-looking model will produce an aggregate support level for rural carriers that is less than that required under the embedded cost mechanics. This belief is not supported by any evidence that in-the-aggregate support will be less.⁹ Proponents appear to have predetermined the outcome of a forward-looking model before it is developed. JSI finds disturbing the fact that proponents have a predetermined solution prior to the examination of the costs for rural carriers. It is well known that a FLEC model result may produce higher, lower, or equal costs when compared to embedded or actual costs. Because the difference between the two methodologies is case-specific, the proponents' ability to state *ipso facto* that FLEC will produce lower overall support levels reveals that their arguments are not grounded in fact and would seem more a ruse to camouflage an agenda to lower rural support regardless of cost. This masquerade should be seen for what it is and rejected by the Joint Board as an unacceptable foundation for public policy.

⁹ Prior to 2000, the HCLS mechanism provided high-cost loop support to both rural telephone companies and non-rural ILECs based on their actual embedded or historic costs. Beginning in 2000, non-rural ILECs began receiving support for their high-cost loops based on a mechanism that uses forward-looking costs. USAC data for non-rural high cost loop support compared to high cost model support in 4Q:2000 shows a 9.4 percent increase in aggregate incumbent support when non-rural incumbents moved to a forward looking cost model. This increase does not include any transitional hold harmless support retained for a defined transition period. See USAC 4Q:2000 Appendix HC10B with Puerto Rico CETCs omitted from the calculation.

JSI joins the overwhelming chorus recommending the Joint Board reject the proposal to adopt forward-looking economic cost as a suitable mechanism for the calculation and distribution of federal universal service support for rural carriers. The evidence presented in this proceeding does not support abandoning the current embedded cost mechanism as the foundation for universal service. Until a forward-looking model is developed and tested, there is no way to determine neither its effectiveness nor its equity in addressing universal service for rural carriers.

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Respectfully submitted,

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/s/ Douglas Meredith

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